UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v. 15 CV 894(WHP)

CALEDONIAN BANK, et al.,

Defendants.

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April 12, 2016

11:14 a.m.

Before:

HON. WILLIAM H. PAULEY III,

District Judge

APPEARANCES

U.S. SECURITIES AND EXCHANGE COMMISSION
Attorneys for Plaintiff
BY: BRIDGET FITZPATRICK
PATRICK COSTELLO
DAVID STOELTING

CARTER LEDYARD & MILBURN
Attorneys for Defendant Verdmont Capital
BY: ROBERT ZITO
MARK ZANCOLLI

PROSKAUER ROSE LLP
Attorneys for Defendant Caledonian Bank
BY: MARGARET DALE
SIGAL MANDELKER MASSIEL
PEDREIRA-BETHENCOURT

(In open court)

THE COURT: Good morning, please be seated.

THE DEPUTY CLERK: SEC vs. Caledonian Bank. Appearances by the SEC?

MS. FITZPATRICK: Good morning, your Honor. Bridget Fitzpatrick on behalf of the SEC.

MR. COSTELLO: Good morning, your Honor. Patrick Costello on behalf of the SEC.

MR. STOELTING: David Stoelting for the SEC. Good morning.

THE DEPUTY CLERK: For the defendant?

MS. DALE: Good morning, your Honor. Margaret Dale for Caledonian Bank and Caledonian Securities. To my right is Mr. Keiran Hutchinson. He's our client. He's a partner at EY and one of the joint official liquidators of the Caledonian entities.

To his right is Sigal Mandelker. She's my partner.

Behind us is Massiel Pedreira, an associate with the firm.

And behind Massiel is Mr. Rupert Bell, counsel to the joint official liquidators in the Cayman Islands.

MR. ZITO: Good morning, your Honor. Bob Zito of Carter Ledyard & Milburn from Verdmont Capital.

MR. ZANCOLLI: Mark Zancolli, Carter Ledyard & Milburn, for Verdmont Capital.

MR. KASOWITZ: Good morning, your Honor. Marc Kasowitz for proposed intervenor Sentinel Trust Services, Limited.

MR. WELCH: And Trevor Welch, also Kasowitz Benson.

THE COURT: Good morning to all of you.

There are three matters that I want to address this morning: First, the SEC's proposed consent judgment with Caledonian bank; second, Sentinel Trust Services' proposed motion to intervene, to object to the consent judgment and seek sanctions or damages from the SEC; and Verdmont's proposed motions to vacate the asset freeze and for summary judgment.

So, with all that in mind, who from the SEC wishes to be heard?

MS. FITZPATRICK: Yes, your Honor. Bridget Fitzpatrick.

THE COURT: If you'd be kind enough to take the podium.

MS. FITZPATRICK: Yes, your Honor.

Your Honor, the SEC respectfully requests that this Court enter the proposed settlement between the SEC and Caledonian Bank. We believe its terms are both fair, reasonable and in the public interests. It represents an appropriate resolution of this action at this juncture. We believe it adequately represents the interests of both parties. It's the product of an arm's length negotiation. And we

believe the terms address the current situation and are in the public's interest.

THE COURT: First, Sentinel complains that they haven't seen the proposed consent judgment. Is there any reason why the proposed judgment can't be docketed, or has the SEC provided Sentinel with a copy?

MS. FITZPATRICK: Your Honor, I believe we sent the proposed judgment to the judgments clerk -- Mr. Costello, I believe, can correct me if I'm wrong -- in accord with the local rules. There is no reason we cannot provide Sentinel with a proposed copy.

They've never contacted us, your Honor. And we had no idea whether they obtained one through other sources. But there's no reason we can't share one with them.

THE COURT: Ms. Dale?

MS. DALE: Your Honor, Sentinel has seen the proposed consent and judgment through the Cayman proceeding.

THE COURT: All right. Thank you.

As I understand the proposed consent judgment, the SEC's proposing a pro forma $25 million recovery from Caledonian Bank but actually collecting zero; right?

MS. FITZPATRICK: That's correct. This is a form of settlement that is frequently used when there are bankruptcy or liquidation proceedings; when the SEC acknowledges that there will be creditors who have priority over the SEC in the

proceeding and will deplete the vast majority of available funds. So in that instance the SEC typically sets the amount of relief at what it believes is appropriate -- here, 25 million -- but then foregoes payment in recognition of the realities of a liquidation or bankruptcy proceeding.

THE COURT: How did the SEC come up with 25 million?

MS. FITZPATRICK: It --

THE COURT: Why not 50 million or 250 million?

MS. FITZPATRICK: Your Honor, that was the product of negotiations. I believe our preference would have been for 34 million. Caledonian's preference, I think, would have been for 1.4 million, reflecting the positions of the different parties. The SEC's position would be that proceeds would be appropriate here. Caledonian's position would have been that commissions were appropriate here. And I think the number was a product of negotiation and intended to roughly reflect about what Caledonian's net equity was at the point that the SEC brought the suit.

THE COURT: But it really is an abstraction, isn't it? What's to negotiate if the entity you're negotiating with is going to pay zero no matter what the number is? I need to understand that.

MS. FITZPATRICK: Yes. I understand, your Honor. I think SEC settlements have precedential value, or that's the SEC's belief; and here, the precedential value of the number of

what we are saying disgorgement would be in this circumstance, if not for a bankruptcy or liquidation proceeding. And we think this is an appropriate number. Given the facts here, if there was not a liquidation proceeding, this would be the number we would settle for and expect payment of. And that's what the number's meant to signal and reflect.

THE COURT: When the SEC reports its end-of-year statistics to the government and the public, is the commission going to count this as a case where it recovered 25 million or zero?

MS. FITZPATRICK: I don't know the answer to that, your Honor. I can ask and advise the Court what happens in bankruptcy proceedings.

I think one metric that is reported is the amount collected. And obviously here that would be zero. How a judgment is reflected when payment is being foregone in light of a bankruptcy proceeding or liquidation proceeding, I don't know how we report that.

THE COURT: I'd like a letter from the commission explaining how this settlement will be reported in the commission's end-of-year statistics.

MS. FITZPATRICK: Yes, your Honor.

THE COURT: I make that request out of curiosity, and also out of what I see to be a growing skepticism in academia that the SEC's reportage of their aggregate monetary penalties

seems to be steadily increasing, but they're not really collecting any more than they were in the past. And specifically, I'm referring to a forthcoming article that I suggest you take a look at by Professor Velikonja titled Reporting Agency Performance: Behind the SEC's Enforcement Statistics, 101 Cornell Law Review 40. I'm curious to see how this case will fit in.

What's the point of a penny stock bar against a company that's gone out of business?

MS. FITZPATRICK: I think, your Honor, again, this is a settlement that is intended to signal what the appropriate relief is for these violations. A company that is going out of business, the penny stock bar is something that for any sale of unregistered securities of this magnitude we would insist upon, since that in some ways is the core of the violation that occurred.

We would also insist on injunctive relief, because that in many ways signals the violation that occurred. You know, settlements are very unique and take a very unique form when there is a bankruptcy occurring. But we tend to still pursue the relief we would pursue in the ordinary course. And that's not something that's fashioned to this specific case. As your Honor can imagine -- in fact, the Court just noted collection problems -- many people go into bankruptcy to avoid payment of an SEC judgment or the consequences from an SEC

judgment. So the terms I think frequently do include injunctive relief across the board.

My understanding -- and I can speak with our bankruptcy lawyers -- is that this closely tracks the type of settlement language we have when there is a bankruptcy or liquidation situation; that the settlement is very consistent with that language. It was not fashioned specifically for this liquidation proceeding. And as an institution the SEC does have an interest in continuing to have injunctive forms of relief on individuals or entities who use bankruptcy or liquidation proceedings to avoid the consequences of the misconduct we seek to deter, your Honor.

THE COURT: Let's turn for a moment to the question of the Caledonian Bank's liability. Under Section 5, Caledonian Bank would be liable as a dealer for participating in unregistered transactions, assuming they weren't covered by an exemption. Based on the settlement papers, the SEC infers that there was no bona fide public offering to trigger the dealers exemption before Caledonian sold the relevant securities.

The question that I have, then, is: Did the agency ascertain the persons from whom Legacy Global or Clear Water obtained their securities during discovery?

MS. FITZPATRICK: So I believe we included a footnote in our memorandum to this regard. We did receive paperwork that indicates that in the files, there were some what we would

call an IBC or shell company in his name. Some of these securities were held I think within Caledonian. It was frequently listed as Legacy Global more broadly being the client. I don't think we've been able to trace everything to the person behind the IBCs. We frequently see a shell company from a frequency bank jurisdiction and names that are listed for that shell company.

But within Caledonian all the orders are being placed regardless of how those line up by Legacy Global and Clear Water and a small percentage by the other individuals we identify as customers in our papers, including I believe the Benson Law Group and Titan.

THE COURT: Anything further?

MS. FITZPATRICK: No, your Honor.

THE COURT: Thank you, Ms. Fitzpatrick.

Ms. Dale, the $25 million judgment's closer to the total proceeds received by Caledonian's clients than it is to the commission's, the $1.4 million in profit that Caledonian Bank made on the transactions. How does that dollar amount account for defenses that Caledonian might have raised?

MS. DALE: Well, your Honor, as soon as the joint official liquidators were appointed in this action, their initial focus was on trying to reduce the amount of assets subject to the restraint in this court, and also seeking to determine whether there was a settlement that was likely to be

entered into expeditiously with the SEC on account of the high costs of determining the facts, frankly. This was -- Mr. Hutchinson and Ms. Lobel were charged with acting in the best interests of the creditors, including the depositors of the bank and the securities company. And so they approached the negotiations with those goals in mind.

With respect to your question, frankly, we never got far enough into discovery to understand all of the facts and circumstances, whether good or bad, your Honor. We quickly came to a resolution of some of the asset restraint to remove it down from a high of $76 million to 10 million. And that released moneys to go back to the Cayman Islands so that the joint official liquidators could make distributions to the creditors. And that money was very helpful, obviously, in doing that. And there have been distributions, your Honor, to the creditors in the amount of 81 cents on a dollar to date.

We negotiated with the SEC over the course of several months. Mr. Hutchinson came up to Washington and participated in those negotiations himself. The joint official liquidators are in consultation with a -- it's called a liquidation committee, but it's essentially a creditor's committee of CBL. And they have been participating along the way in every aspect of the settlement negotiations, your Honor.

So this -- we call them the JOLs, but the joint official liquidators have been the ones who are tasked with

acting in the best interests of all of the stakeholders of the bank and the securities company. And for them, coming out of this case with -- paying no fine and no penalty, and then reducing the asset freeze to $7 million -- which if the Court enters the consent and final judgment, that also will be released -- that was considered a very, very good outcome under the circumstances.

THE COURT: Thank you.

MS. DALE: You're welcome.

THE COURT: Does anyone else want to be heard with respect to the proposed settlement before I turn to the application to intervene?

All right. Mr. Kasowitz?

MR. KASOWITZ: Thank you, your Honor.

Your Honor, I think it's pretty simple. The approval of a settlement requires that there be a finding as to whether it's fair and reasonable and whether it's in the public interest. And here, there's no dispute -- there may be disputes about whether this settlement is fair and reasonable. I have views on that. I don't think that the $7 million was an appropriate injunctive held-back amount.

But there's no doubt that this is not a fair and reasonable settlement to the owner of Caledonian bank. Indeed, there is a unanimous concession on the part of the liquidators that they have not had -- felt bound in any way, shape or form

to even examine or consider the interests of the Caledonian bank. There is a quote from an affidavit from Mr. Hutchinson, I believe, that was submitted in the proceedings in the Caymans that says this: The joint official liquidators -- this is a quote -- have noted the concerns of Sentinel but do not consider themselves bound to take such concerns into consideration in the context of assessing the appropriateness of the consent agreement.

And then it says -- and I found this very interesting, your Honor -- because it is presently insolvent and, therefore, Sentinel does not have an economic interest in the liquidation of Caledonian. It was the actions of the SEC in the first instance which caused Caledonian to be bankrupt and which created the insolvency situation for Sentinel. And that's more a reason that Sentinel's interests should be taken into consideration in determining whether this settlement is appropriate, fair and reasonable.

Secondly, your Honor, public interest. Well, your Honor noted himself -- the Court noted itself that there is a very significant public interest here. It said that this case is a perfect example of a situation where there needs to be self examination for an agency. I can't think of a better case where there needs to be self examination for an agency, because in the first instance, of all of the overreaching behavior engaged in by that agency at the time that the freeze order was

obtained, the misrepresentations that were made to the Court by that agency at the time that the freeze order was obtained, and, your Honor, the lack of action that was taken by the bank and its counsel at the time that the freeze order was obtained, in addition to which, your Honor, the misrepresentations that were made by the SEC continue.

In the settlement memorandum that the SEC has submitted here, I can't put any better gloss on it than this: There is a statement to the effect that documents showing that it had been -- that the money and proceeds were from customers, not from the bank itself, there's this statement made by the SEC that it had just learned of these documents in connection with the exchange of settlement documents with the liquidators. That's wrong, your Honor. It's flatout wrong. The statement was made I think in the briefing in February. It's flatout wrong.

Now, as the liquidators acknowledge, they hadn't turned over any such documents to the SEC in connection with settlement. The fact is that the bank itself had a year earlier, in March 2014, turned over such documents to its own regulator, SEFA. And when and how those documents then found their way to the SEC, which very well could have been for all we know prior to the time that the application for the freeze order was made, none of those facts -- the SEC comes here today for the purpose of trying to somehow make its behavior look

better. In fact, that's a misrepresentation about its behavior. And we still don't know when those documents were in the possession of the SEC.

So the public interest here, for the purpose of the self examination of the agency, has not been served. And, in fact, when I listened to counsel for the liquidators talk about this settlement, it's sort of shocking to me. Let me see. I wrote down some of this stuff.

We never got far enough into discovery to understand the facts and circumstances, good and bad.

We entered into a quick settlement.

We represent the creditors.

And the amount, who knows about the amount.

So at a minimum, your Honor, for the purpose of ascertaining whether or not the settlement is in the public interest for the purpose of determining whether or not appropriate self-scrutiny by the agency and remedying of this egregious overreaching conduct has been achieved or will be achieved, for that purpose, that's not happening with respect to the parties that are before the Court right now. That can only happen with the intervention of Sentinel, which is prepared to go forward with evidence that it has with respect to these issues and to engage in limited, focused discovery to ascertain what the appropriate facts and circumstances are; not just -- I'm struck by this -- good or bad?

THE COURT: What relief is Sentinel seeking in seeking to intervene in this action?

MR. KASOWITZ: Two forms, your Honor: A settlement that is in the best public interest and damages for itself, to the extent that they are available, from the SEC.

THE COURT: But are damages available against the SEC in an SEC enforcement action?

MR. KASOWITZ: We believe that in this SEC enforcement action, your Honor, they most certainly are and should be. We're prepared to deal with any issues with respect to sovereign immunity. We've examined all the cases that relate to it. We believe that sovereign immunity will not be a bar in this situation. We believe that if there ever was a situation where the SEC should compensate a party or an entity for its egregious overreaching and misrepresentations, this is it.

But for their conduct, Caledonian would still be in tact and in business. And Sentinel's equity in Caledonian would be in tact as well. This was all needless, beyond needless. It's actually a tragedy.

THE COURT: Well, what settlement does Sentinel believe would be in the public interest?

MR. KASOWITZ: Sentinel believes that a settlement in the public interest would be one in which, among other things, the creditors continue to be taken care of, as they have been, and that there is -- which it wants to examine as well.

Sentinel believes that there should be a proper amount set forth within the settlement agreement that reflects the reality of the situation, not the fiction that there was either $7 million, $25 million or $35 million worth of harm done by Caledonian. Sentinel believes that there should be damages to Sentinel from the SEC for the liability that the SEC has incurred with respect to its conduct here.

THE COURT: I guess I have to get back, though, to the exchange act. Doesn't it prohibit parties from importing private claims, which is essentially what you're trying to do here, into an enforcement action?

MR. KASOWITZ: I don't believe it does, your Honor. I don't believe that there is a bar to those claims. And if there were --

THE COURT: I think you should take a look at exchange act Section 21G, because the way I read it, it prohibits intervention by a party seeking to bring a claim for damages in an SEC enforcement action.

MR. KASOWITZ: We'll review it, your Honor.

THE COURT: I think that the Supreme Court made the same observation, quite frankly, in *Park Lane Hosiery*. I mean, in the end, while it might be possible for Sentinel to assert some damages claim in a separate action, I think that existing case law forecloses Sentinel's ability to do that in this case through intervention.

MR. KASOWITZ: Thank you, your Honor. And I was going to get to that.

That doesn't foreclose -- and we certainly are and will consider a separate action. And then we'll deal with the sovereign immunity issues. But that doesn't foreclose the appropriateness of Sentinel's intervention here for the purpose of assuring that there is a proper record.

THE COURT: All right. Well, I'm confident the SEC probably has some observations they'd like to make in response to this argument.

MS. FITZPATRICK: Yes.

MR. KASOWITZ: Thank you, your Honor.

THE COURT: Thank you, Mr. Kasowitz.

Go ahead, Ms. Fitzpatrick.

MS. FITZPATRICK: Thank you, your Honor.

I just want to clarify the standard, because I think Mr. Kasowitz says the settlement has to be in the public interest. We believe the settlement is in the public interest. But as the Court is aware, the Second Circuit in Citigroup articulated the standard as, a determination of the settlement does not disserve the public interest. And that's a deferential standard to a law enforcement agency. I just wanted to clarify the applicable case law.

I also want to address briefly the allegation that there was a misrepresentation in the brief submitted in support

of the settlement.

The consent decree and the preliminary injunction had a means for the SEC to obtain documents, which was to make a request through CEMA and for Caledonian to comply with those requests. We did not make these requests prior to bringing the asset freeze because it would have triggered notice to the bank. However, once we agreed upon this process, we repeatedly made requests. Those are confidential. I don't believe they were shared with Caledonian. And after we had reached an agreement on the settlement, which included that process, we received a tremendous amount of documents from CEMA.

We didn't have transparency into when and how Caledonian was giving those documents to CEMA. They didn't have transparency necessarily into our specific requests because there's a middleman and there's confidentiality that covers our communications with CEMA. We received a tremendous amount of material, some of which is attached to our memorandum, that we think is tremendously beneficial to ongoing law enforcement efforts as a result of this process.

But I think that there may have been, based on communications with counsel for Caledonian, a little bit of confusion. And some of the documents may have been provided to the regulator earlier than we thought they were. We construed it as being part of the settlement because we got it after we made the requests that we were making pursuant to the

settlement agreement we reached.

So to the extent the papers are confusing on that front, I apologize, your Honor. I didn't realize it until after we received all the papers that there's any confusion. We did not have access to any of this information at the time we filed the TRO. We think the information further bolsters the case for Caledonian's liability.

I heard counsel to suggest that somehow the settlement is happening, and there's nothing in the record that would support that liability. As your Honor is aware, there was a tremendous amount of record evidence showing the unregistered distribution that was attached to our initial declaration in support of the TRO. We now have even more evidence. If we were to proceed with this case because the settlement was rejected, we would litigate it vigorously. And we would seek -- of course it would ultimately be up to your Honor -- an even greater amount of disgorgement. As I mentioned, this is a negotiated number.

And I just want to explain for your Honor why we view this number as important, even if it's not being paid, and why we would never have settled to a number that was only commissions, even if it was not being paid. And that's because we do think our settlements have precedential value. And we think it's important in this context, where you have repeat players from bank secrecy jurisdictions that are permitting the

sale of unregistered securities, even if it's by their clients, that disgorgement be more than commissions. And that's because a disgorgement is only commissions, and the money is swept offshore and then transferred to the clients from a jurisdiction where if we don't get an asset freeze, we can't get a penalty or collect a penalty, this profit model is profitable. If disgorgement is only commissions, it means that a bank can do this type of transaction for a myriad of customers, and when it's caught, just disgorge what it gained from that single customer and then keep the commissions for all the other customers.

So we believe that it be important when you see this sort of repeat conduct -- and here you do see Caledonian engaging in four sets of unregistered distributions in the midst of what appear to be four separate pump and dumps. When you have a repeat player -- and now that we have more documents, we know these are being done by the same clients, and in incredibly suspicious circumstances of which high-level people are aware at Caledonian -- that disgorgement reflect a higher number.

So in fairness to Caledonian, if we were to continue with this litigation, the SEC would both litigate it vigorously, and we would ask this Court for an even greater amount of disgorgement and possibly a penalty, although we would have difficulty enforcing the penalty in the Cayman

Islands. And I think that context was lost in Sentinel as intervention.

The only other thing I'd like to raise is it's not clear to me that Sentinel is the owner of Caledonian. When I Google Caledonian, the owner is another entity, Caledonian Global Financial Services. And it's unclear to me how Sentinel has standing through these layers of ownership. If we were trying to collect our judgment against Sentinel, I'm sure that they would highlight all these layers of ownership and say that we weren't allowed to do so. But they seem to be just glossed over in the request to intervene in this action, which we do not believe is necessary, both for the reasons your Honor stated and for the reasons we articulated in our letter.

If there are no other questions, your Honor, I think we've responded to Mr. Kasowitz's arguments.

THE COURT: Thank you.

MS. FITZPATRICK: Thank you, your Honor.

THE COURT: Ms. Dale?

MS. DALE: Picking up on SEC's last point, your Honor, "who is Sentinel" I think is an important consideration here.

THE COURT: I will ask Mr. Kasowitz in a moment, so he can bare himself.

MS. DALE: They represent to the Court, they're, quote, the owner of all of the equity, end quote, of CBL and CSL, which is just not accurate from what we understand. From

their filings in the Cayman Islands -- and I will get back to that in one moment -- we understand that they represented themselves to be the sole shareholder of the company that the SEC just referenced. It's called Caledonian Global Financial Services, Inc. And in turn, Caledonian Global Financial Services, Inc. is the sole shareholder of CBL and CSL.

So Sentinel is the parent of an equally insolvent parent of CBL and CSL. CGSFI -- Caledonian Global Financial Services, Inc. -- is in liquidation in the Cayman Islands as well. And the joint official liquidators of Caledonian Bank in Caledonian securities are also the official liquidators of CGSFI.

So I think it's misleading for Sentinel to reference repeatedly that it is Sentinel's equity interest in Caledonian CBL and CSL that is at issue here. In fact, it is CGSFI that has the equity interest in the entities before your Honor.

And as Ms. Fitzpatrick mentioned, Sentinel set up this corporate structure. And it's much more complicated than what I have been able to explain here today. So we assume that they will -- they must abide by the corporate structure that they set up. And they can't simply just drop down to being the sole owner of all of the equity of CBL and CSL.

Also, I should mention this, Sentinel is a creditor of CBL but one of approximately 1,400 creditors. And their ownership -- the value of their creditor interest is

.01 percent of the outstanding creditors. 99.99 percent of the creditors of CBL support this settlement, as does the liquidation committee, which was appointed to provide input to the joint official liquidators, as do the joint official liquidators, as does the Cayman court.

In their letter to you, your Honor, of February 12th, Sentinel failed to disclose that they have previously made the same application before the Cayman court and were rejected. They have already had a full and fair opportunity to object to the settlement. That objection was overruled. And they should be estopped from attempting to raise intervention here. The joint official liquidators, having been appointed by the Cayman court to oversee and be responsible for the estates at issue, are charged with acting in the best interests of all of those stakeholders. And that's what they're doing.

Sentinel, among other creditors, received notice that the joint official liquidators were going to make application to the Cayman court for approval to enter into this settlement. They received that notice. They were the only ones to object to it. They proceeded to make that objection formally before the Court.

There was a hearing on January 26th in the Cayman Islands where the Court heard both sides of this issue. They heard Sentinel's objections. And they rejected them. And in the order that the Grand Court of the Cayman Islands entered,

they said that the joint official liquidators were, quote, authorized to enter consent agreement in the SEC proceeding and to take such additional steps and execute any such additional documents as might be necessary or desirable in order to fulfill the obligations contained in the consent agreement. We've attached that to Mr. Hutchinson's declaration as Exhibit D.

Your Honor, the case of *Cybernaut Capital Management* -- it's a case from your Honor -- it's right on point here. It should control the outcome here. We mentioned it in our letter to your Honor. Just like the petitioner in *Cybernaut*, Sentinel has had that full and fair opportunity to brief its issues before the Grand Court of the Cayman Islands. And they rejected those arguments after considering them. Therefore, they should be estopped.

The only other point I would make is I think Mr. Kasowitz misquoted me, I'm sure unintentionally. I mentioned a quick settlement, not in terms of the settlement of the final resolution of the action, but in terms of the restraining order and the amount that was in the restraining order. That was a key issue for our client. It had been at $76 million, and within less than a month after the joint official liquidators being appointed, we negotiated it down to $7 million. So that was the quick settlement that I was talking about; not the settlement of the action, which took

actually many months more.

THE COURT: Thank you, Ms. Dale.

Mr. Kasowitz, would you like to respond?

MR. KASOWITZ: Sure. Thank you, your Honor.

THE COURT: Perhaps if you could begin with explaining to me what the corporate hierarchy is that makes Sentinel the equity owner of Caledonian Bank.

MR. KASOWITZ: Sure. Counsel just explained it.

Sentinel is the owner of 100 percent of the stock of CGFSI, which is in turn 100 percent owners of Caledonian Bank and Caledonian Securities. Sentinel is the beneficial owner of those interests, your Honor. That's our position here. And so -- it's the party in interest. I heard statements about complicated structures and the like. It's as simple as that.

THE COURT: And CGSFI is in liquidation?

MR. KASOWITZ: I understand that as a result of the activities here and the freeze order, which put a run on the bank, that CGFSI is in trouble, yeah.

THE COURT: Anything further?

MR. KASOWITZ: Yes, your Honor.

With respect to the issue of collateral estoppel, I'll just touch on it quickly. The case that counsel cited, *Cybernaut*, is exactly on point and favors us. It says, among other things, that issues are not identical where the standards governing them are significantly different. And the Cayman

proceeding, the standard that was observed by the fact-finder was, quote, the best interest of Caledonian's creditors, closed quote.

Here, the standard to be determined or to be applied with respect to the settlement is whether the consent decree is, quote, fair and reasonable, closed quote, and, quote, in the public interest, closed quote. Those are different standards. They are not identical. Collateral estoppel does not apply, and we are not a creditor. We are an equity owner.

Thank you, your Honor.

THE COURT: Thank you, Mr. Kasowitz.

Look, I'll fix a briefing schedule, if you want, but I think in the colloquy that we've had, I've tried to make it clear why I don't think a motion to intervene here would be successful. I'm willing to be persuaded to the contrary, if you want to pursue it. And if you decide, after thinking about this, that you want to pursue it, just send me the shortest of letters, and I'll fix a briefing schedule.

But I think that the proposed intervention, as I understand it, is really barred by exchange act, Section 21G, and decisions that have construed that statute to prohibit intervention in enforcement actions.

MR. KASOWITZ: Your Honor, my understanding of those cases was the argument that had been advanced by the SEC -- and I'm going to go back and look at them. But the argument that

had been advanced by the SEC was that intervention would not be permitted without the SEC's consent. And while that has been a position that's been taken by some federal courts in this country, it is not the position in the Second Circuit, where, among other things, courts both in the Eastern District and this Court have taken the position such consent is not necessary. If your Honor is talking about -- I heard your Honor to be suggesting that the issue of damages is precluded by 21G -- that's what we'll go back and take a look at.

THE COURT: And, I mean, even beyond that, though, why aren't your objections here barred by collateral estoppel, given the presentation that you made in the courts in the Grand Cayman Islands?

MR. KASOWITZ: The standards are different, your Honor. There, the specific standard, as I just said is, quote, the best interests of the creditors. Our client is, A, not a creditor; and B, the standard here is different, considerably different. It's talking about a settlement that is fair and reasonable, on the one hand, and also in the public interest. That looks to me to be distinctly different from what is in the best interests of the creditors, which doesn't take into account an equity holder, and certainly doesn't take into account terms like fair and reasonable, and definitely doesn't take into account the public interest.

So I don't think it is barred, your Honor.

THE COURT: All right. Anything further on this point, before I move to Mr. Zito's application on behalf of Verdmont?

MS. FITZPATRICK: Not from the SEC, your Honor.

THE COURT: Anything?

MS. DALE: Your Honor, all I would say on this point is that we've already been waiting more than two months now since we've gotten the authorization from the Cayman Islands court to proceed here. And I think that Caledonian should be reserving its rights to move for sanctions itself for some frivolous motion practice that may delay further the end of this case and the return of moneys to the creditors of Caledonian Bank and Caledonian securities.

Thank you.

THE COURT: And it may not. It may not come to fruition. All right?

Mr. Zito, you've been patient.

MR. ZITO: Good morning, your Honor. May it please the Court.

We have two issues before, your Honor. One is the freeze order, which involves $240,000; I'm rounding up. And the other issue is our proposed motion for summary judgment. Because the SEC's case on its merits is at the heart of both of these motions, I'd like to address that for a moment, your Honor.

As we briefed in great detail, your Honor, on our 12(c) motion at the beginning of the case, we are relying primarily on what's called the so-called dealer exemption. And it's pretty straightforward. We're relying on the date when the -- we're relying on the fact that each of the issuers filed registration statements with the SEC; two, that the SEC declared those registration statements effective; and more than 40 days -- in fact, in some cases it's about two years since that waiting period expired, that 40-day waiting period expired, that all these trades occurred. Therefore, we think we're entitled to the benefit of the dealer exemption and have the case dismissed.

We briefed this in excruciating detail on our 12(c) motion, and remarkably, the SEC never responded to it. And your Honor denied our motion, stating that the Court was unwilling to treat that motion as one for summary judgment. The SEC has now had a year's worth of discovery. Discovery is coming to a close in two weeks. We have a proposed briefing schedule which the Court has now adopted. And I believe our motion is unassailable, because the SEC hasn't responded to why the dealer exemption doesn't apply. The only thing that we've heard, both on the initial briefing on this case and throughout, sort of in passing, is this was a sham. This was a sham. But there's never any articulation as to why that is a sham.

THE COURT: But how will Verdmont show that there's no dispute of material fact that its client's purchases were not part of the pump-and-dump scheme?

MR. ZITO: Your Honor, all as I understand -- and I respectfully submit that our burden on this case is to prove the exemption. For us to prove the exemption, we need to prove three facts. And this is routinely the case, because, in fact, there's a treatise out there that said, if this dealer exemption were not allowed this kind of liberality, the securities markets would come to a complete halt. Dealers are given this exemption. And typically what happens is that a deal will go to the SEC and your website, see there's a registration statement on file, see that it's declared effective and calculate the waiting period. And that's how they make the trades.

So our burden, your Honor, respectfully, we believe, is three facts: One, registration statement on file. The Court can take judicial notice of that through EDGAR.

Two, registration statements deemed effective. Again, the Court can take judicial notice of that fact. It's a matter of public -- it's a public fact on the EDGAR website.

And three, we will prove that the trades took place more than 40 days after the waiting period. In our view that proves the exemption. Now, if the SEC says, well, the waiting period doesn't exactly start then, it should start someplace

else, we don't know when they say that is. They say it's a sham, but it's incumbent upon them. The burden shifts to them, your Honor, to establish that there was some sham. There was some -- we don't know there's a pump and dump. But if they're claiming that it was a pump and dump, they have to prove that our clients were a part of that. And they can't prove that, because we're able to prove that Verdmont's customers were unrelated. They were not the issuers, and they were not affiliates of the issuers or were they insiders.

So even giving the SEC every benefit of the doubt, every benefit of the doubt, your Honor, the fact of the matter is that by the time Verdmont's customers received the stock, the distribution had terminated, had terminated. And they could not be liable because they sold the stock for 40 days after.

But they haven't come forward with any proof. And over a year's gone by, and they haven't sought to take the testimony of people overseas who they say were part of this sham. Not one deposition was taken in this case, other than our clients, your Honor. So I don't know what evidence that they have to come forward and present to the Court that will demonstrate this sham to rebut our exemption case.

THE COURT: Let me turn for a moment to your motion to unfreeze the assets. Didn't you stipulate in June of last year to the asset freeze and waive any argument?

MR. ZITO: No, your Honor. We stipulated to the preliminary injunction, with a reservation that we could move to modify it at any time. That's in the language of the stipulation. Both sides, the SEC as well as Verdmont, reserved their rights. We did not waive anything, your Honor.

THE COURT: What's changed since June 3 of last year when you entered into the stipulation that would justify eliminating the asset freeze?

MR. ZITO: The company has gone into liquidation. The company has completely collapsed as a result of the initial asset freeze in this case of the $17 million and the false publication by the SEC on its website in a litigation release that says that, we participated in $75 million of illegal profits. I mean, once that was out there, we asked them to take that off of the website, and they didn't do that. The business cratered to the point where now we submitted a budget to the Court which shows that there's only -- there was only $455,000 in cash on hand. That's against a projected expenses of this month of $378,000. And that's only allocating $50,000 from my law firm.

And, your Honor, we were all in London taking depositions last week. And that $50,000 was eaten up last week. So for us to start to go into a briefing on the summary judgment motion, we're going to be well behind, and there's not enough money to pay us. And we think that Verdmont should have

the ability of a defense in this case, especially where the case is so thin. There's case law that says that the Court has discretion to allow a release of these funds for the payment of legal fees, and it's fair and it's reasonable. And especially reasonable, your Honor, in light of the stated policy by the SEC lawyers, which is that once -- the stated policy as I heard about 15 minutes or maybe a half an hour ago was that once a company goes into liquidation, they have no interest in collecting money.

So we're in liquidation. They're never going to collect money. So if they had no interest in collecting money, as they cut a deal with Caledonian, why do they even care about the $240,000?

THE COURT: All right. I got it.

Let me hear from the SEC.

MS. FITZPATRICK: And, your Honor, Mr. Costello is prepared --

THE COURT: Sure.

MS. FITZPATRICK: -- for the summary judgment, but if I could just address the liquidation issue.

THE COURT: Yes.

MS. FITZPATRICK: Thank you, your Honor.

I believe Mr. Zito either misheard me or I misspoke. I want to be quite clear: Once a company is in liquidation, we still have plenty of interest in collecting money. We just

recognize the reality that priorities are set by law. And if there are claims of priority over ours, by law, and that those are going to eat up all of the funds, our settlement will reflect that.

I think we're in something of a different situation here. Verdmont does not have a companion bankruptcy case in the United States that recognizes, as was the case with Caledonian, the ongoing liquidation as an official proceeding. So they're in a completely different legal posture.

And here, we have frozen funds that would be available to satisfy our judgment. And the budget we're being shown is saying that those funds will go largely to pay for law firms, and that even that will not get us to the end of the case.

So it's not as if the funds would be available, and then suddenly Verdmont would have counsel fully funded for the end of the case. They would only last about two more months. We would be in the same situation. And the SEC would be left with nothing. We did not construe the budget Mr. Zito presented to this Court, showing how the money would be used if released, as something similar to the type of detailed financial information that Caledonian gave us about how it was going to distribute funds when we lowered the asset freeze that showed that distributions would be made to depositors who complied with certain "know your customer" and other regulations.

Here, the money would be going to lawyers for work that has yet to be done. And it will not be enough. And the SEC and this Court would be left with nothing as a result of this litigation. And we don't think that's appropriate in this instance. And we are willing and able to defend the freeze, if necessary.

Mr. Costello is prepared to discuss the merits of the proposed summary judgment motion, your Honor, if there's no questions on that front.

THE COURT: All right. But it sounds like the motion with respect to the asset freeze has got to be teed up first, doesn't it? Because if I keep the asset freeze in place, undoubtedly Mr. Zito is going to be making an application to withdraw as counsel.

Is that a fair statement, Mr. Zito, or not?

MR. ZITO: May I address the Court from here?

THE COURT: Yes.

MR. ZITO: That's a distinct possibility. I don't know what the work in progress is -- as they say, the WIP, is -- and what the hours are. And once we get to a certain level, I have to go to my executive committee for approvals and things like that. I think we want to litigate this case. We don't want to get hurt, your Honor.

MS. FITZPATRICK: Your Honor, I'm sorry. I just want to add one piece of information.

My understanding is that the depositions last week in London, the principals of Verdmont stated that Mr. Zito represented them personally. And my understanding is also that they represented that there was a $600,000 dividend paid last year by Verdmont. So I think there may be other means of compensation available to Mr. Zito for --

THE COURT: Fair enough.

MS. FITZPATRICK: -- depositions that took place last week.

If Mr. Zito were to prevail on summary judgment, the case would be done and the money would be released. If he were to litigate the asset freeze and prevail, the money would be released. That may cover the litigation in the asset freeze, and maybe there would be enough left for summary judgment. But it's a little bit of a chicken-and-an-egg analysis. That's between Mr. Zito and his client. We're happy for him to litigate everything. We just don't think it's an appropriate basis for releasing the money to pay Mr. Zito and a few other law firms, your Honor.

THE COURT: All right. Thank you.

Mr. Costello.

MR. COSTELLO: Good afternoon, your Honor.

I just wanted to briefly address some of the arguments that counsel for Verdmont had made in connection with the summary judgment or the anticipated motion for summary

judgment. And I think it might be helpful to start by just stating for the Court what the SEC's position on what the applicable standard is in connection with the dealers exemption.

And the SEC refers to the opinion and order that this Court entered in November of last year, where the Court articulated what the correct standard is on the dealers exemption. And that standard is that the dealers exemption applies, provided that the sales of securities are done after a 40-day period dating from either the effectiveness of the S1 registration statements or the time that the securities at issue are first bona fide offered to the public, whichever one of those triggers occurs later.

So the only operative trigger in this instance, your Honor, is not just the effectiveness of the registration statements; the Court also needs to take into account when the first bona fide offering is.

Now, the question here is: Who bears the burden on showing that? Well, as the exemption itself states, and as the Court itself articulated, Verdmont bears the burden on showing the Court when the first bona fide offering of the securities took place.

Now, if Verdmont plans to contend that that bona fide offering coincided with the S1 registration statements being declared effective, then Verdmont can certainly argue that.

But it would be Verdmont's burden to show all of the attendant circumstances behind what a bona fide public offering is. And based on the extent of the record to date, your Honor, there doesn't seem to be any evidence of that even occurring at the time these registration statements were declared effective.

There is a significant amount of evidence to show that the first time that these securities were bona fide offered to the public coincided with the time that Verdmont sold millions of shares of these securities in the public markets in 2013. There is substantial evidence of that. There doesn't seem to be any evidence that there was a bona fide offering at the time that the registration statements were declared effective. But no matter which date Verdmont contends is the trigger date, it's Verdmont's burden to show that.

The other thing I just wanted to point out, your Honor, is one other aspect that might inform how the summary judgment briefing will go. It's case law in the Second Circuit and, in fact, in this district as well, that if a dealer or a broker or a broker/dealer has customers who are acting as underwriters in connection with a distribution of securities, if that's the case, then that entity, that broker-dealer entity, loses the right to invoke the dealers exemption and the brokers exemption.

Now, normally speaking, your Honor, the question of whether or not customers are underwriters is usually answered

in the context of the brokers exemption. That's part of the inquiry. And the Court noted that in its November order.

But if Verdmont is not planning to move on the brokers exemption, then Verdmont needs to show undisputed evidence that its customers were not underwriters, because unless and until a decision is made on that issue, then it cannot be decided whether Verdmont can even invoke the dealers exemption. And there can't be a lingering question of that before the summary judgment takes place.

So Verdmont also will need to introduce undisputed evidence on that front, unless, of course, Verdmont actually decides to move on both of the exemptions, in which case necessarily that analysis would be subsumed within the brokers exemption.

But I just wanted to point that out for the Court. So the SEC plans to oppose this summary judgment motion on the grounds that there is no evidence that these securities were bona fide offered to the public at any time before Verdmont engaged in that distribution in 2013 for all three securities.

Unless the Court has any questions.

THE COURT: Thank you, Mr. Costello.

MR. COSTELLO: Thank you, your Honor.

MR. ZITO: I'll be brief, your Honor.

There's a presumption that when there's a registration statement that is on file, and when it is declared effective by

the SEC, that the securities are in play and they are offered to the public. That's black letter law. That's a presumption. And sometimes an apple is just an apple, a pumpkin is just a pumpkin. There's a registration statement, it's declared effective, and that's it.

Courts have recognized, and your Honor has recognized, that there are some instances where once that registration -- effective date of the registration statement may not necessarily be the date when they are offered for sale. And those are different circumstances. In fact, your Honor pointed to when there are private securities that are at play. And that's not public securities but private securities, because there's no registration statement that's being declared effective in the private securities. So in order to look at the Section 5 claim, you have to look at when they're actually offered, as opposed to when the registration statement was declared effective.

And your Honor mentioned those cases. And I read those cases last night. And they all talk about how this later date really relates to when you have private securities as opposed to public securities. And our case deals with public securities.

And it's our position -- and I don't want to restate it, your Honor; you have heard it already -- they have to prove something in this case. We're going to prove the exemption.

They have to prove this sham theory. And they know that. Otherwise, they wouldn't have spent 40 pages in their complaint talking about all the sham. Although the sham addresses the Swingplane securities, it never addresses the three securities that are involved in this case. They keep talking about the Swingplane securities. So they have no evidence at all.

But all that being said, there are two critical words, your Honor, that I wanted to give to the Court. One is the term underwriter, which is a conclusion. It's a conclusion. It's not a fact. It's a conclusion based on various facts. And the other word is a distribution, a stock distribution.

When a registration statement is on file, you look at what the distribution is. The distribution ends once the stock comes to rest with the general public. Once it goes from the issuer and it rests with the general public, the distribution has ended.

The definition of an underwriter is a person who acquires stock from an issuer, which none of our clients, none of Verdmont's customers, ever acquired any customers from -- never acquired any stock from the issuers or participated in the distribution, insofar as our customers are not affiliates or insiders. And they concede that. They concede that our customers are not issuers or affiliates of the issuers or insiders of the issuers. Therefore, by the time they get the stock, the distribution is over. And they held the stock for

more than 40 days. And the dealers exemption applies. That's the end of the case, your Honor.

THE COURT: Mr. Zito, do you want to file both motions simultaneously?

SPEAKER: They are in a way inextricably related, your Honor. So it may make sense for the Court and the expediency.

THE COURT: When would you like to file them?

MR. ZITO: The discovery cut-off is due the 30th of this month. We would like to have -- we would like to accelerate the briefing on this, your Honor. We'd like to file all our motions by May 15th.

THE COURT: May 16th. Never on Sunday. Right?

MR. ZITO: Thank you, your Honor.

THE COURT: May 16th.

How much time does the SEC want to oppose the motions?

MS. FITZPATRICK: Thirty days, your Honor.

THE COURT: June 15th.

MR. ZITO: Two weeks for reply, your Honor.

THE COURT: June 29th for reply. And for now, I'll set the case down for oral argument on July 15th, but that might change. I'll put it down for 11:00.

With respect to the SEC's motion for approval of the consent decree decision, decision is reserved. I expect that I'll issue an order.

And if the SEC can get the supplemental letter that

the Court requested by the end of this week, that would be fine.

Mr. Kasowitz, if you decide you want to press the motion to intervene in this case, just send me the shortest of letters to that effect, with a proposed date on which you'd be prepared to file your motion. And I'll fix a briefing schedule thereafter.

MR. KASOWITZ: Thank you, your Honor.

THE COURT: Yes, Ms. Fitzpatrick?

MS. FITZPATRICK: Your Honor, I apologize. I believe I may be on vacation July 15th. Is your Honor aware what day -- I don't have my calendar.

THE COURT: That's a Friday.

MS. FITZPATRICK: The Friday the week after the 4th?

THE COURT: That's the 8th.

MS. FITZPATRICK: Okay. Thank you, your Honor. It's fine. Thank you.

THE COURT: So July 15th it is.

Ms. Dale.

MS. DALE: May we have Sentinel's attorney to have by a date certain to get you their letter?

THE COURT: By Thursday?

MR. KASOWITZ: That's fine, your Honor.

THE COURT: That way we'll know.

MS. DALE: Thank you.

THE COURT: Anything else?

MS. FITZPATRICK: No, your Honor.

THE COURT: Thank you all. Have a good afternoon.

(Adjourned)